

BOARD ACTION MEMORANDUM

TO: NCUA Board

DATE: September 29, 2015

FROM: Office of General Counsel
Office of Examination and Insurance

SUBJ: Final Rule: Prompt
Corrective Action; Risk-Based Capital
(Part 702)

ACTION REQUESTED: NCUA Board approval to issue the attached final rule.

DATE ACTION REQUESTED: October 15, 2015

OTHER OFFICES CONSULTED: Regional Offices, Office of National Examinations and Supervision, Office of the Chief Economist

VIEWS OF OTHER OFFICES CONSULTED: Concur

BUDGET IMPACT, IF ANY: This final rule will result in **estimated incremental non-recurring costs of \$2,015,000 spread over three years.** The following details the estimated non-recurring incremental costs:

Non-Recurring Incremental Costs	2016	2017	2018	Total
Revise Call Report and Exam Systems	\$765,000	\$717,000	\$217,000	\$1,699,000
NCUA will need to update the Call Report and the Automated Integrated Regulatory Examination System (AIRES) to accommodate the changes to the risk-based requirement in Part 702. The changes to the Call Report and examination systems need to be resourced primarily via external contractors. Thus, these system development costs necessitate explicit incremental funding. The agency is already working on plans to update both the Call Report and AIRES to replace the outdated underlying technology, improve analytical capabilities, and streamline workflows. To the extent the NCUA Board authorizes and funds these projects, there will be an opportunity to offset some costs by merging the necessary risk-based requirement changes with the broader platform improvements being contemplated.				
Revise Other Affected Data Systems	\$189,000	\$84,000	\$43,000	\$316,000
NCUA will need to update other affected data systems, including risk reports, the Financial Performance Report (FPR), and workload and exam management tools. These changes need to be resourced primarily via external contractors and necessitate explicit incremental funding.				

In addition to the above incremental costs, the agency will utilize existing staff resources to adapt other agency processes for the new risk-based requirement. These efforts including making changes to policies and guidance and providing training. The agency intends to resource the level of effort for policy adaptation and training through existing staff and budgetary resources.¹ While these costs would be absorbed within the customary operating budgets from 2016 to 2018,

¹ The extent to which the agency can rely on internal staff depends on workload and other competing priorities each year.

the estimated resources devoted to updating policies and guidance, and conducting training, would amount to a three-year total of \$144,000 and \$1.6 million respectively.

The agency currently intends to primarily provide the training necessary for staff during National Exam Program Training² in 2018, which historically is part of the normal training time allotment. Provided the agency holds National Exam Program Training in 2018, implementation training on risk-based capital will not result in an increase to the agency budget.

SUBMITTED TO INSPECTOR GENERAL FOR REVIEW: Yes

RESPONSIBLE STAFF MEMBERS: Larry Fazio, Director Office of Examination and Insurance; Steve Farrar, Supervisory Financial Analyst, Office of Examination and Insurance; and John H. Brolin, Staff Attorney, Office of General Counsel.

SUMMARY: NCUA is modernizing its risk-based capital standards to require complex credit unions (those with over \$100 million in assets) to hold capital commensurate with their risk. The overarching intent is to reduce the likelihood of high-risk outliers among complex credit unions exhausting their capital and causing systemic losses—which, by law, all federally insured credit unions would have to pay through the National Credit Union Share Insurance Fund.

In January 2015, the Board issued a second proposed rule to amend part 702 of NCUA’s regulations to fulfill the agency’s statutory mandate to design a risk-based capital system comparable to that of the other federal banking agencies.

The second proposed rule included numerous changes based on over 2,000 public comments received after the original proposed rule was approved by the Board in January 2014. This final rule carries forward significant changes made to the original proposed rule, and makes additional changes to the rule based on over 2,000 additional comments received on the second proposal to ease compliance and reduce the risk weights assigned to certain balance sheet components.

Among the significant new changes:

- Assigning a risk weight of 100 percent to all equity exposures when total equity exposures at a complex credit union are less than 10 percent of the risk-based capital ratio numerator. Equity exposures include investments in credit union service organizations, capital in corporate credit unions, and any other equity exposures;
- Revising the risk weight for share-secured loans to zero percent where the shares securing the loan are on deposit at the complex credit union; and
- Allowing a lower risk weight for certain charitable donation accounts.

The final rule also contains revisions to certain definitions to improve clarity and includes an appendix describing alternative approaches which can be used to determine the risk weights assigned to certain assets.

² Formerly called the National Training Conference.

As required by statute, the risk-based capital measure in this final rule is comparable to risk-based capital measures used by the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve, and Office of the Comptroller of Currency.

NCUA's final rule, however, also fulfills the agency's statutory mandate to take into account that credit unions are non-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers. This final rule predominantly does this by establishing lower risk weights than the federal banking agencies for certain complex credit union balance sheet components where applicable.

After NCUA updates the Call Report system to incorporate more granular data as commenters requested, stakeholders will gain the ability to compare the regulatory risk-weighted capital measurements for complex credit unions to other federally insured depository institutions.

Complex credit unions will have ample time to prepare for the changes in regulatory capital requirements, as the new rule will not go into effect until January 1, 2019. The effective date of the final rule generally coincides with the full phase-in of FDIC's risk-based capital measures.

RECOMMENDED ACTION: NCUA Board approve the attached final rule.

ATTACHMENT: Final rule